RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

SINCE 1958 •

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December 12, 1990 **LETTER 1058**

Nov. 30 DJIA 2559.65; PTI 3165; A-D Ratio -16.72
Dec. 7 DJIA 2590.10; PTI 3174; A-D Ratio -16.04
Dow Yield: 3.98%; Dow P/E: 13.5; DowPow: -800
Dow 200-day MA: 2688; Dow 30-day MA: 2516
Dow Book Value: 1276; PTI 89-day MA: 3201
Percentage of Undervalued Blue-chips: 30%

THE PICTURE: Question: It's been better than two months since the Dow Jones and most of the other stock averages recorded their bear market lows. Since those October lows, a steady stream of unnerving news has surfaced. Isn't it bullish that in the face of all the bad news, the averages have not broken to new lows?

Answer: It would be IF this was a primary bull market. But unfortunately, we're in a primary bear market. In a bear market, values diminish through time. In other words, as a bear market progresses and as the economy contracts, time works against the economy, values, and the stockholder.

I wrote in previous Letters that the July-to-October stock market smash took stocks down too far and too fast. At the July-October rate, the Dow would have declined to zero by mid-1991 -- and that wasn't going to happen. All of which meant that the bear had to use up some time.

Using up time in a bear market means rallying action, corrective action plus sideways action. From its July peak to its October low, the Dow lost a total of 635 points. This represented a primary down-leg in the bear market. On the recovery so far, the Dow has recouped about 36% of those losses. This is well within the normal range of a bear market correction. What is normal? Bear market corrections have historically retraced one-third to two-thirds of the ground lost in the preceding primary decline.

The Transportation Average lagged badly during the initial part of the rally, but on December 5, the Transports obliged by bettering their October high of 883.69. Technically, this is a bullish condition for the secondary trend of the market. Add to this a carload of shorts, and you have a bear market rally that is "fired up." Added fuel for the fire is the perception that war in the Mideast is becoming less and less a possibility.

Obviously, no one can predict where this bear rally will end or how far it will carry. Over the last month many advisors (who should know better) have been publishing extended lists of "short candidates." An eager batch of amateurs, in many cases wanting to make up for losses in their businesses or in their stockholdings, have crowded onto the short side of the market. The result for them is disaster as the violent bear rally presses the shorts to the wall (this situation, by the way, provides a textbook example of why I almost never advise shorting for my subscribers -- shorting is basically a floor trader's game).

Another point to remember is that the bear wants to decline to the lower depths while taking the greatest number of stockholders with him. And this means keeping investors' hopes alive for as long as possible. How does the bear keep hopes alive? Basically, he does it with market rallies, spates of good news -- and with optimistic rumors.

For the bear, hope means new buyers, hope means optimistic brokers, hope means stockholders sitting tight with their shares. So the last thing in the world that the bear wants is to kill hope. It's hope that allows the bear to ride the down-elevator with a full load of passengers aboard.

It is also well to remember that currently the **200-day moving average** (MA) for the Dow stands at **2690**, while the 200-day moving average for the Transports stands at **1038.** So far on this upside correction neither Average has come anywhere near their 200-day MAs. But powerful corrections in bear markets frequently take the Averages back to or at least near to the vicinity of their 200-day MAs. Please keep this observation in mind.

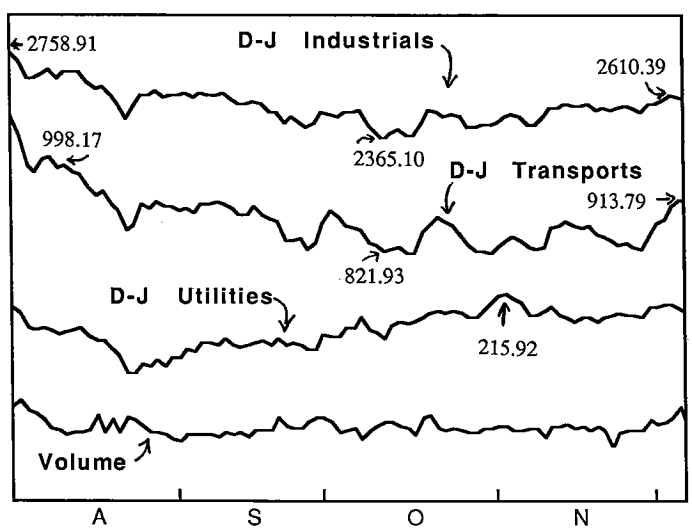
Following are two observations that I have repeated on many occasions. The first is that bear market rallies can be spectacular and explosive, often looking better and more convincing than the real thing. The current rally certainly fits into that category.

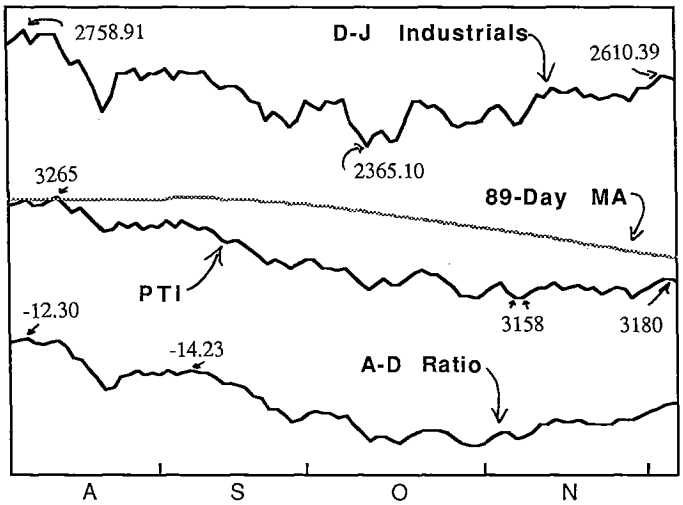
Secondly, I said many months ago that this will be a complicated, deceptive, extended bear market with many rallies and declines, plus long periods of backing-and-filling and tortuous waffling. It was not going to be an easily-read bear market such as 1972-74. I also said that once the economy lapsed into recession (which it now has), the administration, the Congress and the Fed would "fight the bear tooth and nail."

We are at the early stages of the government's "tooth and nail fight" now. Having admitted that the economy is in a "meaningful downturn," Fed Chairman Greenspan has been lowering the Fed Funds rate for the banks. On December 4, the Fed took the additional step of lowering bank reserves. Meanwhile, everyone in Washington from the Congress to the President continues to press for "lower interest rates." The pressure is on, and Washington has now seen all the recession it wants to see (although it must be admitted that many Democrats are not exactly unhappy with the way things are going).

Question: Russell, you keep saying that this is a bear market. But what makes you so sure?

Answer: Once a bull market tops out, a bear takes over. This is as certain as that night follows day. And once a bear market is in force, through hell, hope and high water -- it will go to completion.





The late, great bull market began its topping-out action in 1987, along with the slump in breadth, the crash of October 1987, the later, lesser crash of October 1989, the 1990 collapse in the Transportation and Financial, plus the 1990 top-out in the Utility Average. All of this was part of the huge 1987-90 topping process, a topping process that I've described many times in these Letters.

Given that a primary bear market is now in force, we can expect the market to decline irregularly (over a period of years) until stocks have discounted the worst that can be seen ahead. The question then becomes -- how do we know when stocks have discounted the worst?

One way of knowing is as follows: at bear market bottoms, stocks in general and the blue chips in particular become GREAT VALUES.

Question: Fine, but how do we know when stocks are great values?

Answer: The time-honored way and the best way, is via dividend yield. Along these lines, *Quote Digest* (Box 6600, Rapid City, SD 57709) has published some really outstanding dividend studies.

Quote Digest notes that dividends run in cycles -- up and down within the extremities of a band. At the high end of the range (bull market peaks), the S&P 500 Composite tends to sell for around 30 times dividends. At the lower end (corresponding to bear market bottoms), the S&P tends to sell at around 15 times dividends. The very instructive chart on page 3 (courtesy *Quote Digest)* shows the various swings of the price/dividend ratios. The extremities as shown on this chart jibe with all the major bull and bear markets of this century.

Note that the last extreme in the price/dividend ratio occurred in 1987, at which time the S&P Composite sold at a fantastically high 38 times dividends. History tells us that following such an extreme over-valuation, the odds are high that the bull market is close to, or at, its end.

Actually, the bull market top was in the process of formation all through 1987 to 1990. The actual Dow Theory bear market signal came on January 25, 1990. This meant that the bear had officially taken over. What does this mean to us as investors? It means that somewhere in the period ahead, we can expect stocks to decline to the point where the S&P 500 sells at around 15 times dividends.

How the S&P gets there and what brand of gloomy news will drive it down to that level -- no one knows. It may take a year, it may take five or even 10 years, but you can bet that in due time stocks will decline to the point where the S&P sells at a bargain valuation of only 15 times dividends. Obviously, it will take very bad news, black pessimism on the part of investors, a very pessimistic appraisal of US corporate earnings, to take the S&P down to 15 times dividends. But that's what we can expect, and that's what we should prepare for.

Question: Russell, you say it could conceivably take a number of years before stocks get down to the point where they are selling at only 15 times dividends. What am I supposed to do in the meantime, twiddle my thumbs?

Answer: Twiddle them if you like, but consider this: the alternatives to stocks today are many and very attractive. You can get 7% returns on T-bills, over 8% on German marks, 9% on ECUs, plus you are offered very attractive returns on all kinds of money market funds.

Over a 50-year span, the total return (appreciation plus dividends) on common stocks has averaged around 10% a year. Today you can get that in any number of good corporate bonds. You can get 9% or better in high-quality foreign paper. You can get 10% or better in many of the closed-end global funds. So I don't consider it tortuous to sit out this bear market on the sidelines (meaning out of stocks). The attractive, high-yielding alternatives to stocks are almost too numerous to mention.

Interesting Item: "Investors Flooding to Stock Funds" is the heading of an article in the November 30 *Wall Street Journal.* The article adds that the public is "buying shares in stock funds at a record pace."

Strange, I thought the public was depressed and frightened. But consider this: after the 1987 crash the public sold, and the Dow subsequently went to new highs. After the 1989 semi-crash, the public sold and again the Dow went to new highs. Evidently, the public isn't going to be suckered this time; despite the bear market they're buying stock funds hand over fist this time. Will the public get it right this time? I doubt it.

I've been calling this "the Idiot Stock Market" because it reacts minute by minute, hour by hour to the latest rumor or theory or suggestion regarding Saddam Hussein and the Mideast. So the next section is entitled:

WHAT ABOUT THE MIDEAST? President Bush took an initial strong stand on Hussein and Iraq. The stand was, "Get out of Kuwait or else." There were to be no negotiations, no jaw-boning -- the Bush demand was set in stone. Hussein's takeover of Kuwait "will not stand," repeated the President. Then came the expected Bush waffling. Before we do anything, let's get a consensus from the UN, get a consensus from the American people, get everyone to agree that Hussein must exit Kuwait and that we have the right to throw him out if he won't get out peacefully.

Was the Bush ultimatum another "Read my lips" promise or was it something more? We'll never know, because time has eroded whatever it was that Bush had in mind. Bush worked hard for a "world okay." It finally came in the form of a UN agreement (ultimatum?) to the effect that Iraq must exit from Kuwait by January 15 -- or else. At that point the future seemed clarified. Hussein must move his troops out of Kuwait or face the wrath of the UN forces.

Then, two weeks ago, Mr. Bush stated that he was sending Secretary of State Baker to talk to Hussein. But the ultimatum was in place. What was there to talk about? Bush didn't say. Then last week Mr. Baker announced that Iraq would be safe if it would only leave Kuwait and set the hostages free. As far as the other goals (remember them?), war crime trials, reparations for Kuwait, knocking out the Iraqi nuclear, chemical and poison gas capabilities -- well, forget them. That was then, this is now.

So right before our eyes, we see Bush's original policy deteriorating, falling apart. And the question arises -- can Bush even carry out the threat of an attack on Iraq after January 15? It seems doubtful that he can. Why? Congress has been having hearings, and a string of high-ranking brass has been telling Congress that an attack on Hussein would be a rotten idea. The preferred strategy would be to wait -- to see if the sanctions will work.

At this point it is highly doubtful whether Bush alone could send the troops against Hussein. Rather it seems that Congress would have to declare war. But would Congress declare war -- even after the January 15 deadline? That too seems highly doubtful.

My feeling is that the whole situation has turned into a sort of propaganda circus. Everyone is getting into the act -- the US' top brass, the UN, the CIA, Congress, foreign commentators and politicians, the Bush cabinet, the newspaper polls, the TV stations. The Democrats, sensing a wedge into the Bush presidency, are now questioning or objecting to every move the President makes.

As I see it, the whole Bush strategy is being weakened or undercut. Hussein, it seems, has out-smarted Mr. Bush simply by waiting him out and by feeding ammunition to the opposition. On December 6, Saddam announced that all foreigners will be free to leave Iraq and Kuwait (a nice Christmas present from a nice guy). Thus, Saddam has conformed with one of the Bush preconditions for a peaceful settlement. This "easing of tensions" by Saddam is a clever tactical move, and some might consider it a master-stroke. By freeing the hostages, he has eliminated one of Bush's main rationales for attacking Iraq.

So I ask myself -- has time run out for Bush's original strategy of freeing Kuwait and eliminating the menace of the megalomanic Saddam Hussein and his arsenal of chemical, poison gas and potential nuclear weapons? Or has Saddam out-foxed the American president through a series of clever manipulations and with the aid of time? As matters now stand, it looks to me as though Saddam (whether in or out of Kuwait) is going to be around for quite a while.

BUT WHAT IF THERE'S WAR?: Question: How would the markets react to war in the Mideast?

Answer: The general expectation is that the US, through overwhelming air power, would knock Iraq out of action in a matter of weeks. However, of late this assessment is being increasingly challenged. With a huge build-up of almost half a million men, Hussein's approach is for a long, drawn-out war, a war that would be very costly in terms of US casualties. To put it briefly, the US wants a quick air war, Hussein wants a drawn-out ground war.

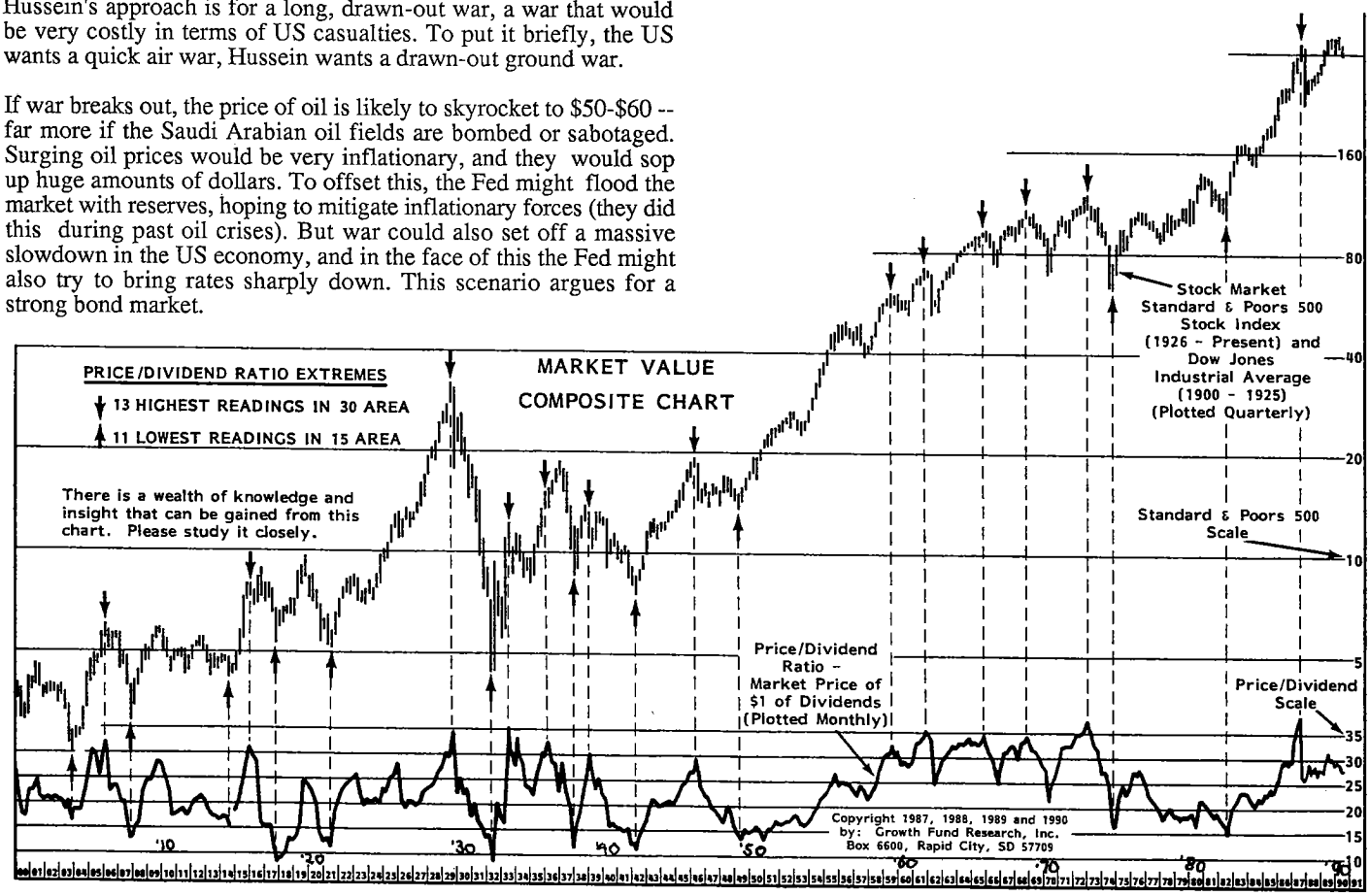
If war breaks out, the price of oil is likely to skyrocket to $50-$60 -- far more if the Saudi Arabian oil fields are bombed or sabotaged. Surging oil prices would be very inflationary, and they would sop up huge amounts of dollars. To offset this, the Fed might flood the market with reserves, hoping to mitigate inflationary forces (they did this during past oil crises). But war could also set off a massive slowdown in the US economy, and in the face of this the Fed might also try to bring rates sharply down. This scenario argues for a strong bond market.

All the above notwithstanding, the usual reaction to war is inflation and rising interest rates. The main reason for this is that wars are hugely expensive. With the US already staggering under the onus of record deficits, the outbreak of war (particularly if the war is to be a long one) would throw even the most pessimistic deficit forecasts into a cocked hat (in the event of war, the federal deficit for 1991-92 could rise to over half a trillion dollars).

Furthermore, it is clear that the current dollar has not been performing as it has during past crises. Today, the dollar is not acting as an island of safety in the face of the Mideast mess. Therefore, if war breaks out, one can only wonder what the fate of the dollar would be. My own guess is that war would be bearish for the dollar. If so, then our foreign dollar holders (who have already sustained terrible losses on their dollar-denominated holdings) might want to exit the dollar market. This could mean a sell-off of US bonds and higher rates for dollar-denominated items -- all this regardless of what the Fed would like.

Conclusion: Although the answer to the war question is necessarily clouded, one thing is sure -- war would push the current out-of-control US budget off into space as federal deficits surge to new record highs. Over the long term (if not the short term), the skyrocketing US deficits would be bearish for the dollar, for bonds and for stocks.

Comment: Retired Rear Admiral Gene La Rocque (director of a private think tank) told a Congressional committee last week that in the "best professional judgment" of military specialists at the center, the following can be expected: in a six-month war against Iraq, the US should expect to sustain 45,000 casualties of which 10,000 would be deaths. Iraq would suffer 135,000 casualties, 35,000 deaths. Iraq civilian casualties from bombings would be 100,000. Assuming three months of heavy fighting, another three months of low-level conflict and nine additional months of occupation of Iraq, the US military costs alone would be $80 billion. The estimate does not include equipment replacement costs, additional veterans' support, aid for rebuilding Iraq, higher oil prices or the effect of increased interest rates on the US economy.


PRICE/DIVIDEND RATIO EXTREMES
13 HIGHEST READINGS IN 30 AREA
11 LOWEST READINGS IN 15 AREA
MARKET VALUE
COMPOSITE CHART
There is a wealth of knowledge and insight that can be gained from this chart. Please study it closely.
Stock Market Standard & Poors 500 Stock Index (1926 - Present) and Dow Jones Industrial Average (1900 - 1925) (Plotted Quarterly)
Standard & Poors 500 Scale
Price/Dividend Ratio - Market Price of $1 of Dividends (Plotted Monthly)
Price/Dividend Scale
Copyright 1987, 1988, 1989 and 1990 by: Growth Fund Research, Inc. Box 6600, Rapid City, SD 57709

INVESTMENT POSITION: In the 1930s there was a definite island of safety among the financial wreckage brought on by the Great Depression. That island was the dollar, widely held to be "as good as gold." I was there in the 1930s, and I can tell you that there was only one problem -- no one had any dollars. It wasn't a question of the value of the dollar (we used to buy a full course Sunday dinner for 90 cents), it was a question of "How do you get your hands on a few dollars?"

Today it's different. Today, the dollar isn't tied to anything of intrinsic value. The dollar simply floats against other currencies. There are plenty of dollars to be had (our government spends over a billion of them every day). The problem is -- what's a dollar worth?

The answer to that is "I don't know. I don't know what a dollar's going to be worth one month or six months from now, and neither does anyone else." So the dollar isn't a store of value any more. The dollar is basically just a medium of transaction. Our government doesn't define what a dollar is or guarantee the value of the dollar, it simply tells you, "This note is legal tender for all debts, public and private" (read the writing on your one dollar bills).

So what's a poor investor to do? In my opinion, he has to **DIVERSIFY.** In a bear market, if he's going to lose buying power in one area he should try to make it up in another area. One area of diversification out of the dollar is into the hard currencies. Let's think about it.

Germany will be drawing on both its domestic and foreign savings to finance and modernize the wreck that was formerly known as East Germany. To do this, Germany will require high interest rates and a STRONG Deutsche mark. Since a number of European nations tie their currencies to the mark by choice or as members of the European Monetary System, these nations too will be required to have strong currencies.

What about the dollar? With the US economy weakening, the Fed will have to make a choice between (1) bolstering the dollar by holding interest rates at a comparatively high level, or (2) lowering rates and letting the dollar fall. I think it will be "no contest." The Fed will opt to lower rates and allow the dollar to go where it may.

On top of this, US finances continue to deteriorate and this hardly endears foreigners to the dollar. Thus, I have been telling my subscribers to diversify, to refrain from holding all their assets in dollars. How does one do this? One choice is gold, another choice is the hard currencies. I have been recommending positions in both. In the last Letter, I listed a number of places where the currencies can be purchased. In the currencies, the best choices are the German mark, the Swiss franc and the ECU.

There are a number of closed-end international bond funds that are listed on the NYSE. A few deal only with government paper, and yields on all are attractive at 9% to over 10%. Funds you might look into are Templeton Global Governments (TGG), Templeton Global Income (GIM), Global Government Plus Fund (GOV), Global Yield Fund (PGY), Putnum Premium Income Trust (PPT), World Income Fund (WOI). I bought some shares in each. Why? They look interesting, they offer juicy yields, and I just want to watch them. They are also an easy way to diversify. Finally, most are well down from their original offering price, and most now sell at a discount from actual assets.

As you probably know, mutual funds sell at their actual asset price (minus the load factor if there is one). When you buy a mutual fund, you buy it from the issuer and you sell it back to the issuer. Closed-end funds are bought and sold on the exchange like any other stock, and they may at any time sell at a premium over asset value or a discount from asset value.

NOTES & QUOTES: Be SURE to read the editorial in the Dec. 3 issue of *Barron's* by Christopher Whelan entitled, "Devaluation and Debt, That's What Passes for Economic Policy in Washington These Days." That suburb piece says it all.

* *

From the *Kondratieff Wave Analyst*, Box 977, Crystal Lake, Ill. 60014: "By 1995, at the present rate of increase, US government debt will total $6 trillion, and the interest on that debt, assuming current rates prevail, would be more than $500 billion per year. And, of course, if the US economy suffers a serious recession or depression during the 1990-95 period, a much higher debt total and a much higher annual interest burden would prevail. It is entirely conceivable, under such circumstances, for the annual interest charge on this debt to reach $1 trillion by 1995. I would add only that a serious recession or depression between now and 1995 is, in my opinion, a certainty. I am equally certain that it has already begun."

* *

Euphemisms, "double-speak," gobbledegook and outright lies continue to be the language of Washington. In his November appearance before Congress, Fed Chairman Greenspan talked about a "meaningful downturn" (what the hell does that mean?) in the economy, but he never once used the word recession. Meanwhile, Washington's economists wait for the two successive quarters of decline in the GNP so that a recession can be announced -- officially.

* *

From our "It ain't over 'til it's over" Dept. -- on November 15 an article in the *WSJ* noted, "Texas Real Estate Market Still Sliding, Bankers and Appraisers Now Concede."

Rephrasing a popular expression: "It ain't over until the fat lady lip-synchs."

* *

If you live in California as I do, you can start worrying about new state taxes. Why? The golden state is running a deficit of $1 billion this year and it is estimated that the state will run a deficit of near $6 billion next year. But heck, we started out in this recession with a round of higher federal taxes, so why not let the states get into the act too (item: two-thirds of the states are now running deficits, and I'm not even talking about the cities). San Diego's Pete Wilson is our new governor. Why he wants the job, damned if I know (of course, governorship in California can be a stepping-stone to the presidency).

*

You may have been a big Reagan fan; I was for the first few months of his presidency, but when I saw him completely ignore the budget deficits, I lost my enthusiasm. The new Reagan book "An American Life," is not turning out to be the seller that Simon & Schuster hoped it would be (they paid $6 million for the rights). Waldenbooks is already discounting the book by 25%, and the talk is of a slew of returns to the publisher.

* *

Speaking of the Great Communicator, the following is from the current *Playboy* interview with Chrysler CEO Lee Iacocca. Iacocca: "I once asked President Reagan, 'What policies are there? What's your monetary policy, what's your fiscal policy, what's your trade policy, what's your energy policy? Tell me in twenty-five words or less.' Of course, he didn't know what the s--t I was talking about."

* *

The big accounting firm of Ernst & Young estimates that employee stealing is seven times greater than outside shoplifting.

* *

The theory behind convertible bonds is that when stocks are hot, the conversion factor pushes the bonds up. When stocks are falling, the safety of the bond feature plus bond interest rates tend to hold the bonds up. That theory works well if (1) the given convertible bond is high quality, and (2) if you're not paying too much of a premium over conversion for the bond.

Value Line's index of 580 convertible bonds has lost 17% since January, and Kidder Peabody states that the average yield on convertibles has risen from January's 6.9% to today's attractive 10.5%. What happened? As stocks fell, the premiums on many convertibles declined, bringing down the bonds (in many cases, the stocks are now far below conversion price, which makes the bonds unattractive as convertibles).

High grade convertibles become bargains near the bottom of a bear market, particularly if they sport good yields. Why? The bonds allow you to get paid handsomely while waiting, and at the same time you have a call (or hedge) on the coming bull market.

* *

Former tycoon Robert Campeau, up to his neck in debt, has put his 24,000 square foot Toronto mansion up for sale. Creditors want the money, and Campeau Corp. continues to be in debt -- to the tune (would you believe) of $13 billion.

A lawyer and bankruptcy specialist wrote this letter to the *New York Times* (Nov. 29). The letter has the ring of truth in it, and I publish it here in its entirety.

By William J. Rochelle

What's all this debate about whether a recession is coming or whether one has already begun? Don't worry. It's not a recession. It's a depression.

In my profession, bankruptcy law, we are seeing dozens of formerly wealthy real estate developers. Not long ago, we heard about a developer whose net worth previously had as many digits as his Social Security number. Now, his net worth is his Social Security number.

The developer was asked what some of his properties might bring if he had to sell them in nine months. He said that he really didn't know what his assets were worth, because there was simply no one buying real estate.

In the Northeast today there is just no market for many assets. What is an asset worth when no one will buy it? How can the regulators measure the banks' solvency when no one knows what their collateral is worth?

The absence of a market distinguishes this recession from the ones before it. Parts of the U.S. had serious real estate recessions in the 1970's. Florida and Georgia, for instance, were heavily overbuilt. But the troubled assets did sell.

Today, nothing sells. The banks have dropped out of the business of making new loans, and properly so. Banks should not be making new loans when prices are dropping.

The reluctance to lend will continue because the bottom is not yet in sight. So far, the recession has only wrung out some of the speculative fever that inflated prices in the 1980's. The asking prices will not allow the buyer an adequate return on investment. Today's prices continue to reflect an expectation of substantial appreciation. The real break in asset prices will come when values reflect earnings potential and realistic demand.

William J. Rochelle is a bankruptcy specialist with the law firm Fulbright Jaworski & Reavis McGrath.

On the demand side, the bottom also is yet to arrive. Consumers, like large companies, need two or three years to exhaust their working capital. Real estate developers saw the market turn two years ago, but their problems became public only when their working capital was gone.

While layoffs have depresssed many families' incomes in recent years, their working capital has not yet been exhausted. When it is gone, either they or their bank lenders will start dumping assets to repay debts.

So far, individuals and companies are holding their assets, even if they have been on the market for a year. Enough sellers who are forced to sell will bring a price collapse. When the big bust occurs, how far under water will the banks be then?

Sixty years ago, the failure of the banking system prevented the economy from recovering without help from a war. Other circumstances are the same now as they were in the 1920's. For instance, it is said that everyone in the 1920's rode around in limousines, but they were all rented. When was the last time you saw a stretch limo that was owned?

I worry whether the bank regulators and Congress know how bad it really is with the banks. If they know, are they trying to keep it a secret? The latest rumor I heard was that nearly every major New York bank would be merged, perhaps with ailing California banks.

Even if depositors never lose a dime, what will happen if the country's big, money-center banks go through a collapse like that in in Texas in the 1970's? Southwestern banks still are not making loans. Developing or sustaining an economy without bank credit is nearly impossible. Without banks to stimulate the economy, how can a recession help but turn into a depression?

Some years ago, I asked a veteran bankruptcy lawyer what it was like in the Great Depression. The first few years were great, he said. But after a while even bankruptcy lawyers couldn't make a living because no one had money to buy assets from bankruptcy trustees.

I thought about that old bankruptcy fox when that formerly wealthy developer said that no one would buy his assets. I am frightened. I took Donald Trump's advice, "Cash will be king in the 1990's." So I put my money in bank money market funds.

With what I am now seeing in the banks, I don't know whether federally insured bank deposits are good enough. I am going to buy Treasury bills. When the banks start failing, I don't want to be caught underneath.□

The wealth of America, and certainly of the all-important middle-class, is in its homes. I've been warning that if the US real estate picture starts to unravel, it's going to be a major bearish factor in the recession picture. Today, there's no doubt about it -- US real estate is deflating. Furthermore, the deflation is even hitting NYC rental apartments. Ever since World War II, apartment rentals have been hard (some say impossible) to find in Gotham. Now, suddenly, this has changed, and the price of apartment rentals (wonder of wonders) is actually coming DOWN. Here are a few very recent clips from the *WSJ* and the *NY Times*.

A 50-Year Rise in Rents Ends In Many New York City Areas

By ALAN FINDER
Special to The New York Times

NEW YORK, Nov. 27 — For the first time since the Great Depression, apartment rents are dropping in much of New York City.

Real-estate professionals say rents have dropped at least 5 percent to 10 percent — and in some cases as much as 20 percent and more — in a variety of city neighborhoods during the last three years.

Rents on luxury apartments have dipped occasionally over the last half-century, but this is the first time that the number of [illegible]

been as central to New York's fabric as traffic, noise and glitter. The decline in rents has produced fundamental changes in many of the unwritten rules and rituals that have made finding a decent apartment a distinctive New York ordeal.

No longer do prospective tenants routinely find it necessary to scour obituaries to discover vacant apartments, or bribe doormen, superintendents or managing agents to gain first rights to a vacancy

Burst Bubble

As Home-Price Slump Reaches California, Risk to Economy Rises

Costlier Houses Slip 10%-25%, Construction Dwindles, And the Ripples Spread

Free Mercedes With Purchase

By Jim Carlton
Staff Reporter of The Wall Street Journal

TRABUCO CANYON, Calif. -- A builder auctioned off 27 expensive homes in the exclusive community of Coto de Caza last month, at prices about 25% below what homeowners had paid for identical residences earlier this year. The dismayed original buyers now allege that the builder has a "moral obligation" to make sure they don't lose money on their homes.

Real Estate Woes Seen Worsening

Commercial Values Expected to Plunge In Next 2 to 3 Years

By RICHARD D. HYLTON

The slump in commercial real estate is almost certain to get worse before it gets better, real estate executives, bankers and other business people say.

In a recent survey of 400 real estate executives conducted by Ernst & Young, the accounting firm, many predicted that prices of commercial property would fall sharply in the next two to three years and might not [illegible] for four or five years.

[illegible] many

Speaking of real estate, Yasushi Mieno, the Bank of Japan's governor, has gone on record as saying that he would like to bring down property prices by around 20%. From all accounts, that's about what has happened in Japan and around Tokyo. But shooting for a "soft landing" is a dangerous policy. History tells us that deflation has a habit of getting out of control.

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In the meantime, Ivana Trump has slapped liens on Donald Trump's three homes. Ivana should have grabbed the original $25 million offer (if that was really the arrangement). At this point, Ivana is simply an unsecured creditor of Donald's (behind the secured creditors such as some of the banks, lawyers, employees, etc.) and, as I understand it, behind the IRS as well. Didn't they say in the beginning that "Ivana should just take the Plaza." At this point, it looks like she should have taken anything she could get.

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Back in the good old days of the roaring, soaring '80s, a seat on the NYSE went for over $1 million. But Wall Street's suffering now, and a few weeks ago a seat on the Exchange sold for $250,000. This was the lowest price since two seats sold for

$260,000 each back on November 26, 1982. The price of a seat, by the way, has always been an excellent gauge of how people are doing on Wall Street.

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I just received an interesting book by Michael O'Higgins entitled, "Beating the Dow: Low-Risk Method for Investing in the D-J Industrial Average With As Little As $5,000" (Pub. Harper Collins). The author deals only with the 30 Dow Industrial stocks. His calculations cover the years 1973 to 1989. O'Higgins purchases the 10 highest-yielding Dow stocks at the beginning of each year and his total return is a remarkable 17.9% per year (this does not include taxes or commissions, however). Then he offers another method: owning the 10 lowest-priced Dow stocks with the highest yield. This method yielded an amazing 20.9% a year over the 17-year period. The author then goes into even more exotic ways of beating the Dow. It's a book worth reading. Question: how will these methods work in the future? Answer: No one knows. If the next 17 years are as good as the last, the methods will probably be good ones. If the US goes into a major period of decline over the next 17 years, O'Higgins' formulas could easily backfire. Don't forget, the Dow was in the 1050 area in January 1973 and in January 1989 it was just under 2200. That was undoubtedly a help to Mr. O'Higgins.

* *

My old friend Don Morris (*Donald Morris Newsletter*, PO Box 19909, Houston, TX 77224) notes that there are now 5.2 billion people on the earth, of which 4 billion live in the third world. In the next decade, the world will add another 1 billion to its population. The developed world's rate of population increase is now less than 1% a year, while the third world is increasing at the rate of 2% a year (in some countries 3% a year). To put it in perspective, the third world population is doubling every 25 years! Concludes Morris, "Every political, economic and social structure humanity has ever devised is breaking down from sheer indigestion, coping with numbers and demands they were never designed to handle. The final Grim Reaper -- the fifth Horseman of the Apocalypse -- is sheer fertility, which can only be reduced by cheap, safe and effective contraception." Russell comment: I worry about all this, but I worry more about the world's collective psyche and the inability of humanity (taken together) to logically confront and solve problems.

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Observers are worrying about "the 80% solution" for the Mideast. What's that? Hussein pulls out of 80% of Kuwait, keeping the other 20% including the oil fields, two islands, and the knowledge that he had faced the US down. This would leave Saddam in a position to earn huge profits with oil, and he would have the time and money to build up a large, technically advanced military with which to dominate the Mideast and its enormous oil reserves. Pressure from Congress and the US public could conceivably force Bush to swallow the deal.

* *

What are the world's safest commercial banks? Only six banks are now rated AAA by the prestigious International Bureau of Credit Audits (IBCA, London). They are: Barclays in Britain, Germany's Deutschebank, the Dutch Robobank, and Switzerlands three big banks, Credit Suisse, Swiss Bank Corp. and Union Bank of Switzerland.

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David Fuller (*Fuller Money*, 7 Swallow St., London WIR 7HD, UK) monitors and charts 26 international stock markets. In his latest report, he notes that the global bear market has taken the 26 markets down an average of 35% from peak to bear market low. Worst performers: Taiwan down 80%, Philippines down 63%, Japan down 48%, New Zealand down 48%, Thailand down 48%, S. Korea down 44%, Austria down 43%, Sweden down 41%. Dave notes that "most of the world's stockmarkets are currently in trading ranges. Those patterns reveal an approximate balance between supply and demand, which both reflects and creates uncertainty."

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Top yielding D-J Industrial stocks now are Goodyear 11.6%, Sears 7.7%, GM 7.6%, Allied Signal 6.5%, Union Carbide 6.2%, Alcoa 5.6%, Texaco 5.3%, Westinghouse 4.9%, Exxon 4.9%, Eastman Kodak 4.8%.

GOLD: My old friend, Bill Tehan, has completed a new report. Bill sees the world moving away from dollars because of a declining US economy and out-of-control financial problems. Up to this point, the flight has been out of dollars into other currencies. Tehan notes that in the 1930s, the problems were credit deflation and depression and the flight was into the dollar and into other currencies with intrinsic value. Today, no currencies have intrinsic value and no currencies are convertible into gold.

During the credit inflation of the 1970s and '80s, the world's central banks accumulated around 40 billion dollars. This huge hoard of dollars constitute the major reserves behind the Bank of Japan (80% in dollars), the German Bundesbank (60% in dollars), the Bank of England (81% in dollars) and the Swiss National Bank (40% in dollars) -- all figures taken as of the end of 1989.

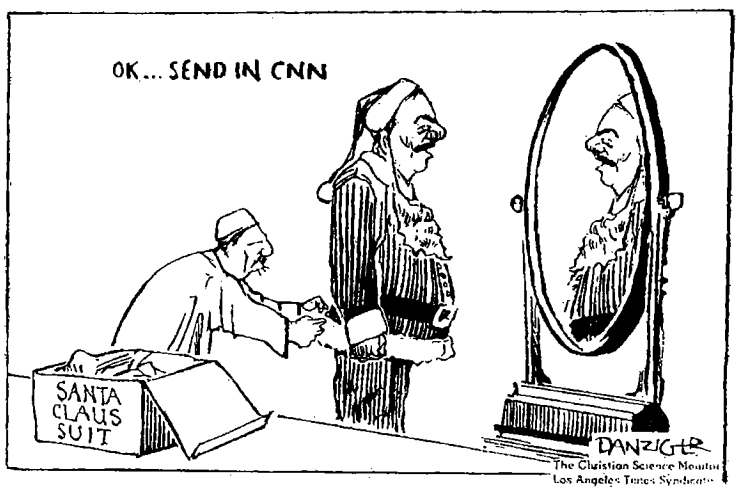
Tehan's point is that when you buy the currencies of these various countries, you are buying a currency that is still backed largely by dollars. Thus, the dollar risk remains.

In the coming world deflation which Tehan foresees, banks of all nations will come under pressure as will the currencies of the various nations. This will set off a massive move toward safety -- toward a currency with intrinsic value. Today there is only one currency that offers intrinsic value -- gold.

Tehan believes (as I do) that a new bull market in gold has started. He believes (as I do) that the action of February through June was simply a reaction in the new gold bull market.

Incidentally, there's much talk of gold being linked to the coming European Monetary System. When the new single-currency is created, the conservative Europeans (particularly the Swiss, French and Germans) are going to insist on stability. Linking the new common currency to gold would provide stability. I think the gold link is coming.

I think I'm early on this, but **SEASON'S GREETINGS** to all my loyal subscribers in the US and around the world. I wanted to get Santa Claus in here somehow, and I guess this cartoon fits the bill (anyway, I got a laugh out of it, and these days you need all the laughs you can find).



LATE NOTES: From its July peak to the October low, the Dow lost 635 points. The halfway level is 2683. Under the 50% Principle, if the Dow can cross decisively ABOVE 2683 that would be an important plus in the recovery picture. If the Dow stalls out below 2683 and then turns down, expect it to test and then break below the bear market low of 2365.

The bond rally and declining US interest rates are triggering new weakness in the dollar.

NEXT MAILING: December 26